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E.R. BROOKS
Chairman, President and Chief Executive Officer

May 9, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
504 House Office Building
U. S. House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

Enclosed please find Central and South West Corporation's (CSW) responses to your letter of April 10, 1997.

As you may be aware, Governor George W. Bush convened a press conference on May 5, to announce a comprehensive plan to restructure the electric utility industry in Texas, including retail customer choice. CSW strongly supports the Governor's initiative and will work toward its adoption in the Texas Legislature before the 1997 session concludes on June 2.

Thus, our position on a federal solution to electric utility restructuring and the issues you have raised in your letter will depend on what happens in the Texas Legislature in the next few weeks, although we have made every effort to provide exhaustive answers.

With the above discussion in mind, we are pleased to submit our responses.

Sincerely,



ERB/dkl
enclosures

1. From your company's point of view, is it necessary for Congress to enact legislation bearing on retail competition, and why? If you favor legislation, please outline which issues should be addressed and how you think they should be resolved.

From the point of view of Central and South West (CSW), it is not necessary, at this time, for Congress to enact comprehensive legislation bearing on electric utility restructuring including direct retail access. Restructuring is an idea whose time has come and, by the end of this year, there will probably be no state that will not be addressing restructuring on either the state legislative level or the state regulatory level, or both. Federal preemption is not needed at this point to generate movement at the state level toward competitive restructuring of the electric power industry. Moreover, most of the critical factors involved in successfully designing workably competitive, commodity-like markets for electricity vary by state (and by region) and will result in different market designs depending on the locality of the market. For instance, the amount of generation compared to load will vary by state as will the type of generation (base, intermediate and peak) and the vintage of the generators (whether the mix is relatively new or relatively old). Fuel mix will also vary by state and region where one state's generators are predominantly gas-fired, while another state's primary fuel is coal.

Other state-by-state variations include the number of potential generating entities available to bid into the market in each state and the resulting ability of those generating entities to exercise market power, each state's preference about how the state is going to address the mitigation of market power and, above all else, differences among the states in the amounts of stranded costs that will need to be recovered as part of the transition to competition. Finally, different states will have different preferences concerning how much customers in the state are willing to pay for reliability, the need for and funding of a universal service fund, funding for stranded benefits (DSM and renewables), who will bear the obligation to serve or, at least, perform the role of supplier of last resort, what to do with public power and how will individual state commissions be restructured at the end of the transition to competition.

However, Congress will have a role to play in the transition to competition. For instance, Congress must repeal outdated laws such as the Public Utility Holding Company Act of 1935 and the Public Utility Regulatory Policies Act of 1978. Also, CSW believes the industry is moving toward regional markets, probably coterminous with the existing regional reliability councils. It may be necessary for Congress to promote the evolution of regional bulk power markets by authorizing the creation of regional entities such as regional Independent System Operators (ISOs) or regional commissions which have sole authority to address regional market issues and which, in part, preempt some of the existing authority of state commissions and the Federal Energy Regulatory Commission (FERC). Such issues could include transmission line siting authority, regional transmission pricing, regional market structure, and regional market power mitigation. More importantly, Congress will have a major role to play in the transition to competition if the states "get it wrong" by refusing to address critical issues such as stranded cost recovery.

2. If the state(s) you serve has adopted or is considering adopting retail competition, what are your biggest concerns? Please be specific. Indicate how you are dealing with them and any recommendations you may have.

All of the states served by CSW, including Texas, Oklahoma, Arkansas and Louisiana are considering retail competition and Oklahoma has passed legislation to implement retail competition by 2002. Our biggest concerns are several. Will these states properly implement a wholesale competitive bulk power market in advance of offering customer choice? This is a critical, but often overlooked, precondition for successful implementation of customer choice. It is also a very difficult matter to address because a workable wholesale bulk power market must reconcile conflicting imperatives. In order for the market to be economically efficient, it must clear periodically at the marginal operating cost of the last unit needed to meet demand. This in turn requires some consideration of generator market power and the ability of generators to raise market prices above marginal cost. Conversely, the market clearing price must provide enough margin, over and above marginal operating costs, to cover the sunk costs of the generators and to attract capital when new capacity is necessary to meet increased demand. The problem of reserve capacity must also be addressed because no generator is going to provide reserves unless they are paid to do so. This would suggest the need for additional mechanisms to provide capacity payments at some level over and above the market prices generators receive for their output. Unfortunately, the debate over customer choice is long on platitudes and generalities but short on the details about how a bulk power market will be implemented.

Although members of the legislatures in all of the states we serve are sensitive to the appeal of "customer choice," another major concern is whether the members will properly balance whatever benefits customer choice could bring with the substantial costs and risks associated with the implementation of customer choice. In a competitive, commodity-like market, prices will change continuously with large swings in the level of the market clearing price. It will then be necessary to match individual customer consumption in each time period (every half hour, probably) with the market clearing price in that time period. The metering changes, data gathering systems and settlements procedures necessary to accomplish this task will be complex and costly. Also, someone must balance the physical load when individual generators over- or under-generate. Someone must provide replacement generation when other generators have unscheduled failures and those "someones" will want to be paid. Customer choice also means service unbundling where companies will emerge in the marketplace to aggregate loads, read meters, provide billing services, connect new customers to the distribution grid, perform service restoration and even service disconnection for customers who do not pay their bills. All of these new market entrants will require a margin for providing these services and when all of the above services have been paid for, customers may have choice but electric service may cost more.

Our greatest concern is the recovery of stranded costs and the mechanisms that will be offered for recovering those costs when no one knows in advance the market prices necessary to calculate the magnitude of stranded costs. For example, assume an average

weighted market clearing price of 25 mills per Kwh. If a generating entity with a portfolio of generators can generate at an average operating cost of 20 mills per Kwh, then the average margin will be 5 mills per Kwh. Also, assuming that the average load factor on each generator (ignoring reserve capacity) is 60% (typical in this part of the country), then each Kw of capacity will generate about 5000 Kwh per year, producing a margin of \$25 per Kw per year (5 mills times 5000 hours). The capitalization ratio in the electric utility industry is about 6, meaning each dollar of margin per Kw can support a capital investment of \$6 per Kw. In the example above, 6 times \$25 per year would support a capital investment of \$150 per Kw. This means almost every generating entity in the country will have stranded costs because the average undepreciated investment in all generation in this country exceeds \$150 per Kw and is probably closer to \$300 per Kw even excluding nuclear units. On the other hand, if market clearing prices turn out to be 35 mills per Kwh, then the market could support embedded investment in existing generation of \$750 per Kw (15 mills times 5000 hours). The second scenario will, on a theoretical basis, vastly reduce the magnitude of the stranded cost problem (except for nuclear units where undepreciated embedded costs can exceed \$3000 per Kw) and lead to accusations that unregulated generators will make too much money.

Added to market price uncertainties, are the uncertainties associated with stranded cost recovery. The standard litany on this subject appears to be that the recovery period should be as short as possible but utilities should not be allowed to raise existing rates in order to recover stranded costs. Since existing rates are based upon 30-year plus recovery periods for generation investment, attempting to recover a substantial portion of these costs in a one- to five-year period presents an interesting challenge.

In order to address all of the concerns mentioned above, it is essential that public policy makers understand and address the many complications and complexities that will inevitably accompany the implementation of customer choice. This will require a transition period during which the details of restructuring can be worked out among all interested parties. Fortunately, the legislatures in all of the states served by CSW appear to recognize the need for such a transition period during which legislative task forces and study committees can address all of the major ramifications of customer choice before actual implementation occurs. Needless to say, CSW will be an active participant in this process.

3. Whether or not you favor federal legislation, please indicate your position on the following specific issues (to the extent not addressed in your responses):

- a. *A federal mandate requiring states to adopt retail competition by a date certain. If retail competition is under consideration in the state(s) you serve, do you believe Congress should provide additional direction or authority?*

Assuming all of the states we serve address the critical issues involved with restructuring in a reasonable manner, a useful date certain that Congress could provide would be a date certain for the implementation of regional wholesale bulk power markets. This would require the states in a given region to synchronize their individual restructuring agendas so

that implementation of such a market can occur across all of the states in the region at the same point in time. Whether individual states should add a customer choice module to the demand-side of a competitive wholesale bulk power market should be left to the states along with the timing of implementation. The decision to implement customer choice and the timing of implementation is inextricably intertwined with the magnitude of the stranded cost problem in each state or each region and the outcome will vary by state or by region.

- b. ***Recovery of stranded investment.*** If the state(s) you serve already has adopted retail competition, how was this issue addressed and are you satisfied with the outcome? If your state(s) is considering adopting retail competition, how would you recommend that this issue be treated? Do you think Congress should enact legislation relating to stranded cost issues, and if so, what would you recommend? Is securitization a useful mechanism for dealing with stranded costs, and whom does it benefit?

Congress need not enact legislation related to stranded cost issues unless the states fail to do so. FERC has already established federal policy in Order No. 888 that utilities are entitled to full recovery of stranded costs. For Congress to delve more deeply into the mechanics of stranded cost quantification and recovery in an effort to produce a standard stranded cost recovery package would be an exercise in frustration because the parameters of the stranded cost problem vary so widely across states and regions. Besides, if Congress “gets it wrong” one way or the other, it will be the states that bear the consequences.

Securitization is an extremely useful mechanism for dealing with stranded costs because, once a utility’s stranded cost burden has been securitized, all participants in the marketplace, including investors who will be providing the future capital needs of the industry, will know with certainty the cost of recovery and all participants can then proceed with restructuring with a major impediment behind them.

- c. ***Reciprocity.*** Can states condition access to their retail markets on the adoption of retail competition by other states? Should Congress enact such a requirement? Could such a requirements create an incentive for states with low electric rates not to adopt retail competition, in order to keep cheap power at home?

Employing reciprocity as a lever to compel states to adopt customer choice has constitutional ramifications. Where one state adopts customer choice but a neighboring state does not, reciprocity would mean that power produced in the neighboring state could not cross the state line between the two thereby restricting free trade among the states. Further, the reciprocity lever is not necessary to spread customer choice because, as soon as electric customers in one state have customer choice, customers in neighboring states will want the same thing.

Assuming market prices for power will be set by the marginal cost of the last increment of output, whether regulated electric bills are high in one state and low in a neighboring state should have no impact on the spread of competition. This is because the marginal costs of generators located in both states located approximately at the same place on the dispatch

curve should be approximately the same resulting in similar market prices for both states that are part of a regional power exchange. What causes the differences in electric rates between the two states is not the relative marginal energy costs of the generators in those two states but the differences in stranded costs of the generators in those two states which market prices will ignore. Stranded costs will be collected separately and will still be borne by the customers in the states where the stranded costs are located.

4. **If Congress enacts comprehensive restructuring legislation, should it mandate “unbundling” of local distribution company services? What impact would this have, and would the effects differ for various customer classes? Would this entail substantial expense, and who would incur any such costs?**

Congress should not mandate “unbundling” of local distribution company services. How far unbundling of distribution services advances should be determined by the market itself. If new market entrants can offer distribution-related services at better prices and/or better values than incumbents, then the unbundling pendulum will swing quite far until it reaches a point where the distribution services offered are so minute and so trivial that their total cost exceeds their value for most customers or the margins on these services are so thin that the provider cannot survive at which point the pendulum will reverse directions and distribution services will be rebundled.

Unbundling comes in several packages in a competitive market. There is functional unbundling (generation, transmission, distribution and customer service), rate unbundling (where the functions are priced separately), service unbundling (power delivery, meter reading, billing, etc.), and customer class unbundling. The last type of unbundling is often overlooked but there will be no customer classes in the world of customer choice. Each customer will “win” or “lose” depending on the cost to serve that customer.

5. **Recently Chair Moler of the Federal Energy Regulatory commission recommended that, as part of comprehensive legislation, Congress authorize the Commission to enforce compliance with North American Electric Reliability Council standards to help maintain reliability of service. Do you believe this is necessary and why or why not?**

There will have to be a “sheriff” in each of the bulk power markets with the authority to enforce the necessary but often conflicting trade-offs between economics and reliability where occasionally market participants may be tempted to compromise system security in order to improve their profit margins. The “sheriff” will also have to deal with situations where additional capacity is needed but “market” prices are not sufficient to attract capital. However, where that authority is eventually located remains an open question. Moving such authority to the regional level may make more sense than trying to place the entire burden on one national institution.

6. **What concerns does your company have with respect to the role of public power and federal power marketing agencies in an increasingly competitive wholesale electric market? In markets in which retail competition has been adopted? Are there concerns you would like to have addressed if Congress enacts comprehensive restructuring legislation? Should**

Congress consider changes to federal law as it applies to regulation of public or federal power's transmission obligations?

A pattern appears to be developing in all of the states that are deeply into the restructuring process where public power entities are either exempted from restructuring or restructuring is optional on the part of such entities. The penalty for not restructuring generally is a requirement that public power entities build a fence around themselves and not participate in the restructured market. This raises an interesting question as to why competition will be good for some electric customers but not for others. However, unless competitive restructuring proves a total failure, it will be difficult for public power entities to hide from competition behind their fences when their customers demand customer choice. Public power argues that restructuring will jeopardize their below-market cost or tax-free financing and this raises other interesting questions as to why any entity in a competitively restructured industry should have access to below-market cost or tax-free financing to build generation and why any generating/transmitting/distribution entity that does not want to be subjected to retail or wholesale competition should escape FERC regulation and, in some cases, state regulation.

7. If Congress enacts comprehensive restructuring legislation, should changes be made to federal, state or local tax codes, and if so, why? Please be specific.

In many states, taxation of utilities is anything but uniform. However, as part of the restructuring process, each state should have the opportunity to revise its utility tax structure so that each market participant pays state and local taxes on the same basis as all other similarly situated market participants. At the federal level, there is no reason why every generating entity participating in the competitive marketplace, whether privately or publicly owned, should not be taxed on the same basis including a uniform application of income taxes. Uneven tax policies confer competitive advantages and disadvantages and prevent competitive markets from functioning properly. Carried to an extreme, generating entities with tax preferences could drive out all generating entities that do not enjoy such preferences until the only surviving generators are those subsidized by the federal government.

Another matter that the federal government should address is the mitigation of stranded costs for utilities with nuclear generation. Since the federal government was the father of nuclear power in this country, some child support payments would be in order in the form of funding some portion of stranded cost write-downs through federal income tax credits.

8. What, if any, concerns do you have about the reliability of the electric system? If the industry moved to retail competition, will adequate reserves be available? Is the transmission system capable of handling full retail competition?

The relationship between customer choice and reliability will be totally determined by the structural characteristics of the wholesale bulk power market. The market must operate as a single control area under the direction of an ISO or other similar institutional entity. The ISO must also operate a power exchange or similar functional entity from which the

ISO can acquire power on a second-by-second basis to keep load and generation continually in balance. The ISO must have access to and control over sufficient generating resources to provide the market operating and planning reserves to cover temporary shortfalls in power supply. The ISO must have redispatch procedures in place to cover temporary transmission constraints. In addition, the ISO will probably require the authority to reinforce the regional transmission grid when parts of the grid approach the limits of their transfer capability and some mechanism for inducing new generation to enter the market when demand threatens to exceed supply. If the wholesale market is properly implemented, customer choice will not impact the reliability of the bulk power market because customer choice is essentially a gigantic paper settlement process occurring after-the-fact and should not affect the physical operations of the bulk power market.

9. If Congress enacts legislation on retail competition, should changes to the Public Utility Company Holding Act [sic] of 1935 (PUHCA) be included? If so, what would you recommend? In particular, how should Congress address market power concerns in any such legislation? Are transition rules needed during the period before effective competition becomes a reality?

Congress should repeal PUHCA now. In fact, Congress should have repealed the Act back in 1982 when the SEC initially recommended to Congress that it should. PUHCA, and its repeal, truly has nothing to do with the substantive debate over deregulation of the electric industry. PUHCA was enacted solely to regulate the corporate structures and securities of utility holding companies to protect investors. PUHCA was not intended to address either retail service or competition issues. PUHCA is not limited to electric companies. It restricts directly the three registered gas companies and indirectly the many exempt gas companies. Moreover, PUHCA has nothing to do with the generation, transmission, or distribution of electricity. PUHCA, furthermore, has nothing to do with rates, either wholesale or retail. All serious studies of the Act have concluded that PUHCA has outlived its usefulness due to other laws, regulations, and regulatory bodies and should be repealed. It simply is no longer necessary and should not be held hostage to any restructuring efforts or any other Federal legislation. And it should be repealed now.

PUHCA is a costly redundancy and anachronism. PUHCA's regulatory requirements continue to impose substantial costs on registered companies, their consumers and their shareholders. Significant benefits would be achieved for consumers and shareholders through repeal of PUHCA, whether retail competition occurs quickly or is phased in.

If a stand-alone PUHCA bill is enacted, the provisions of Senator D'Amato's bill, S. 621, will bring consumers and shareholders the benefits of PUHCA repeal. While we do not believe any new regulatory authority is necessary S. 621 provides certain federal and state regulators with access to books and records, affiliate transaction review, and audit authority that the FERC and NARUC have requested. Although we believe PUHCA repeal should be quickly addressed in a stand-alone bill, any PUHCA repeal should reflect the terms of S. 621.

If legislation on retail competition is enacted, outright PUHCA repeal should be included. In such a bill, PUHCA should be repealed in its entirety for the discipline of the market will protect consumers from costs, investments, or unwise business decisions. Furthermore, PUHCA's repeal should be effective upon enactment--not at some date following retail competition. Most of the electric industry is free now to prepare for competition, the PUHCA companies are not. Other non-electric companies that may be interested in joining the competition in the electric industry are also free to develop market share now. The PUHCA companies are not.

There is no need to tie PUHCA repeal to implementation of retail competition. H.R. 655 could cause substantial implementation problems as well as significant competitive harm to certain companies. Because the applicability of PUHCA's restrictions would depend on the actions of individual states under H. R. 655, different registered companies will find themselves subject to different federal regulatory requirements, depending upon the states in which they operate. Those companies that continue to be subject to PUHCA, because one or more states in which they operate are slow to implement retail competition, will be at a competitive disadvantage.

We do not support the PUHCA reform sections of Chairman Schaefer's comprehensive legislation which does not provide for outright repeal of PUHCA. Rather, H.R. 655, provides that PUHCA "shall not apply" to those registered systems unless and until the states in which all of its utility operating companies serving customers have implemented retail competition.

Some have asserted that it is essential to retain PUHCA in order to limit what they call "concentrations of market power" as the electric industry restructures. Those who make that assertion either do not understand the role PUHCA has played, or willfully misstate it. PUHCA's existing provisions actually increase the likelihood of concentrations in particular markets, because the "integration requirements" and geographic restrictions of the Act limit both registered companies and exempt companies to retail utility holdings in particular areas, and restrict the ability of more distant companies to acquire, construct or operate facilities that could compete with the local utility. PUHCA effectively keeps new entrants out of markets, and keeps registered companies from engaging in competitive lines of business. Indeed, PUHCA as it stands, requires utilities to limit acquisitions to nearby utilities -- ones that can be integrated or that do not result in a loss of exempt status. Those nearby utilities are the ones most likely to have presented the possibility of competition.

Repeal of PUHCA will not create circumstances where additional mergers will foster increased concentrations of market power. As the SEC itself stated in its report two years ago, its policy toward mergers and acquisitions in the utility industry has been one of "watchful deference" deference to the determinations of FERC and the State Commissions regarding the efficiencies or other benefits to be gained, and the conditions to be imposed on any proposed utility merger possibly subject to the Act.

It is important to recognize several facts about mergers and market power assertions if PUHCA is repealed. First, the very same expert agencies who today substantively review mergers will do so after the '35 Act is repealed. FERC will retain all of its merger authority, it will pursue consideration of its merger policy, and, indeed, it will have the assurance that future mergers will not create new Ohio Power or other similar regulatory conflicts at the federal level. State Commissions will still have their authority to approve, block or condition mergers that they have today under state law. PUHCA's repeal will have no effect on that. The Department of Justice will retain its antitrust authority under the Sherman Anti-Trust Act, and the Federal Trade Commission and the Department of Justice their Hart-Scott-Rodino authority. The only thing that will change when PUHCA is repealed is that after all of those approvals are given, the SEC will no longer have the unnecessary and duplicative regulatory burden of again stating its deference to the decisions the other regulatory agencies have already reached. As the number of mergers proposed, announced, or accomplished in the last two years shows, FERC and the states have ample authority and experience to address market power issues. The repeal of PUHCA will not affect the regulatory oversight of mergers.

Congress should take no action on the so-called market power issues and should defer to state regulatory proceedings for market power issues. While FERC does consider evidence of market power effects on retail competition, it generally leaves questions regarding market power at the retail level to be addressed by the States. (See recent FERC opinion & Order issued April 16, 1997, authorizing proposed merger of Baltimore Gas and Electric Company and Potomac Electric Power Company in Docket Nos. EC96-10-000, et. al.). At the same time, DOJ has become more interested in market dominance issues particularly with respect to mergers if it will reduce competition in retail electric markets. In cases where state commissions lack adequate authority under state law to thoroughly investigate market power concerns then legislation assuring that FERC has authority to review retail market power issues should be enacted. Transition or interim measures such as the formation of an Independent System Operator, adopted by FERC in its recent Merger Policy Statement (See Order No. 592 issued December 18, 1996) should be considered in any retail legislation while markets become competitive.

Because PUHCA repeal would have no anticompetitive effect, no transition rules are required during the period that retail competition is implemented.

10. To what degree, if any, have recent Securities and Exchange Commission administrative orders and Rule 58 decreased the need for legislative changes to PUHCA? Assuming these actions withstand any court challenges, what are your major remaining concerns about the Act?

The very few and severely limiting orders issued by the SEC has done little to obviate the need for PUHCA repeal. Each order is based on specific facts for each specific company and viewed under the anachronistic and arbitrary restrictions the Act imposes on a small subset of the industry. No one order extends to another company and some companies are denied opportunities other registered companies were granted based on the merits of each application. The recent orders increasing investments in EWGs and

FUCOs grant relief from restrictions that do not burden any of our competitors or other utilities. Virtually all other companies are free to make such investments without limit. We know of no other companies with restrictions on how to spend retained earnings. To continue such arbitrary, baseless restrictions on a handful of companies undermines sound public policy and is punitive.

The SEC's interpretation of PUHCA is overly strict. The SEC recognized in its 1995 report, that it does not have the authority on its own to eliminate the extraordinary and unnecessary burden that PUHCA imposes on registered companies, their consumers, and shareholders. The SEC, under both Republican and Democratic administrations, has been asking Congress to repeal the Act for years, otherwise its orders granting relief will continue to be of limited value and scope.

Rule 58 did not administratively repeal PUHCA. Rule 58 simply codifies previously authorized acquisitions of "energy-related" businesses that were deemed to be "functionally-related" to the core businesses of gas and electric public utilities. These businesses have withstood the test of time as benefiting both consumers and investors. The specific list of activities is limited and only includes activities that most of the companies have permission to engage in now. Included are such activities as energy conservation, demand-side management, power plant engineering and environmental licensing.

Rule 58 does not remove the restriction of other companies owning public utilities. It does nothing to eliminate the requirement that these companies must expand regionally if they are to grow. Companies are still required to obtain permission from the SEC before any change in corporate structure takes place. Permission is still needed before any security can be issued. The rule simply does not address most of the unnecessary restrictions imposed by PUHCA that continue to apply to only 14 electric and gas utility holding companies.

Since its enactment in 1935, PUHCA has allowed registered holding companies to own businesses that are "reasonably incidental, or economically necessary or appropriate to the operations" of such companies. Rule 58 only allows the 11 electric registered holding companies and 3 gas holding companies to make limited investments in limited "energy-related" activities that have been deemed "appropriate in the ordinary course of business". Fully 80% of all electric and gas utilities have been engaged in these activities without limit for years. Rule 58 finally brings some relief to a small subset of the entire gas and electric industries. Furthermore, only one commenter objected to the proposed rule when initially released because at the time everyone knowledgeable about PUHCA and the rule recognized its reasonableness.

By issuing Rule 58, the SEC is not straying into matters that must be decided by the Congress. The SEC issued Rule 58 in an attempt to keep up with the technological changes of today's electric and gas industries which increase efficiencies of services provided to the consumer. Additionally, Rule 58 attempts to keep up with the recent initiatives of the Federal Energy Regulatory Commission (FERC) in opening up the

electric and gas industries and the state commissions legislative mandates for customer choice. Furthermore, the SEC is trying to keep pace with the legislative changes Congress has made to PUHCA over the years in response to changes in the gas and electric industries beginning with the Public Utility Regulatory Policies Act of 1978 (PURPA), the Gas Related Activities Act of 1990, the Energy Policy Act of 1992, and the Telecommunications Act of 1996.

Rule 58 does not remove the diversification limits of PUHCA. Rule 58 provides a very specific and limited list of “energy-related” businesses that registered holding companies and their subsidiaries can acquire. The list is limited to what has been approved in the past. There is not one new business on the list. The list includes activities such as energy management services and demand-side management services, development of electro-technologies, development of equipment relating to electric and compressed natural gas powered vehicles, renewable energy resources, power plant engineering, environmental licensing, and the like.

Rule 58 does not exempt “energy-related” activities from any regulatory review. The rule requires extensive reporting of the nature and amount of every investment in “energy-related” activities, with the SEC and every state commission with jurisdiction over any public utility owned by any registered holding company. Furthermore, the rule does not impact the ability of FERC or the state commissions to review all costs and investments made in “energy-related activities” in carrying out their respective rate responsibilities which ensures effective protection of ratepayers, as is the case with all other utilities.

Rule 58 does not allow unlimited investments in “energy-related” activities. Rule 58 places a cap of the greater of 15% of consolidated capitalization (value of stocks and long-term debt) or \$50 million (some registered holding companies subject to PUHCA’s restrictions are so small that 15% of consolidated capitalization would not be equal to \$50 million) on the amount that registered holding companies and their subsidiaries may invest in “energy-related” businesses.

Rule 58 does not authorize registered holding companies to issue an unlimited amount of securities to finance the acquisition of “energy-related” businesses. Rule 58 did not grant any authority to issue any security. Any issuance of any security to fund the acquisition of an “energy-related” business has to be approved by the SEC under PUHCA.

Rule 58 does not allow the registered holding companies and their subsidiary public utility companies to make capital contributions and open account advances (cash) into “energy-related” businesses without limit. All capital contributions and open account advances are subject to the cap of the greater of \$50 million or 15% of consolidated capitalization.

Rule 58 does not allow the registered holding companies and their subsidiary public utility companies to guarantee the financial securities of an “energy-related” subsidiary without SEC authority. Rule 58 does not allow the issuance of any guarantee for whatever reason without obtaining SEC authorization.

Rule 58 does not allow the acquisition of international companies. Rule 58 authority is limited to “energy-related” businesses within the United States.

Rule 58 will, however, benefit either consumers or investors. The “energy-related” activities (such as energy conservation to which Rule 58 applies) have been shown to be virtually free from risk of failure. In fact, the SEC has determined that each of the listed activities “are consistent with prior orders” and “are not detrimental to the protected interests [consumers and investors]”. During the public comment period, only one party filed any opposition to the Rule and did not object to most of the listed activities. Why? Because no one disputes the expertise these companies have in activities such as facility design and greenhouse gas reduction. And no one disputes the benefits to consumers and investors.

In addition to savings to the registered companies, taxpayers stand to benefit from the Rule as well. According to the SEC, Rule 58 will result in approximately \$1 million per year in legal, accounting, and management savings of the 14 PUHCA companies and almost 3,800 hours (approximately 2 staff years) of SEC staff time!

Even with the recent orders and Rule 58, registered companies continue to be limited to the operation of a single integrated system. Registered companies continue to be restricted to investments in industries the SEC deems “reasonably incidental” to a utility system. Registered companies continue to require prior SEC approval before entering into any service, sales, or construction contracts with affiliated public utility companies. Registered holding companies continue to be prohibited from borrowing from subsidiaries, and loans from registered holding companies to their subsidiaries continue to be subject to SEC regulations. Registered companies continue to be subject to SEC regulation of their decisions to declare dividends or retire debt.

Although the SEC has recognized that PUHCA is no longer required, Rule 58 and other administrative reforms of PUHCA are subject to recession or reinterpretation. Without the clarity of repeal, the registered companies continue to have potential limitations, the costs of which are borne by the registered companies' customers. Without the clarity provided by legislation, the registered companies may avoid reasonable investments that they could later be required to divest if the SEC changes course.

11. As electricity markets have become more competitive, some have asserted that PUHCA prevents consumers from receiving the full benefits of competition. Do you agree or disagree, and why? Is competition in wholesale or retail electric markets dependent upon the participation of the registered holding companies? Is it a certainty that changes to PUHCA would enhance actual competition? Please provide specific examples to illustrate your answers.

PUHCA clearly bars consumers from receiving the full benefits of competition. PUHCA not only substantially increases the costs of the registered companies, active current participants in the energy market, but also restricts the entry of new

competitors whose participation could create a more active and robust market. PUHCA imposes on the customers and shareholders of registered companies tens of millions of dollars in lost business opportunities, lost efficiencies, and additional transaction costs not borne by any other industry participants. Thus, in a competitive environment, PUHCA imposes a substantial handicap on registered companies. Moreover, even with competition, the costs PUHCA imposes on registered companies will keep the price paid by consumers artificially high. PUHCA imposed costs must be borne by the consumers who buy registered companies' power. Other competitors are artificially restricted from entering markets, or compete in restricted markets that effectively have higher prices than would otherwise prevail.

Because PUHCA imposes costs and limitations on any company owning 10% or more of a public utility company, PUHCA severely limits the number of companies willing to enter electric power market, thus decreasing competition and increasing the cost of power paid by consumers.

In order to avoid PUHCA, new entrants are directed into only specific modes of competition, QFs, EWGs, or power marketers and some efficient modes of competition, or some competitive opportunities, are foregone.

For example, pursuant to California's restructuring plan, California has encouraged the big three utilities in California to divest a significant portion of their generation assets. Ideally, the divestment would permit new market entrants to purchase the newly available plants and serve retail customers or the Power Exchange. But, few investors will want to subject themselves to PUHCA by purchasing facilities that cannot be held as QFs or EWGs. Thus, the price of the generation assets will be depressed, increasing the stranded costs that California's consumers will have to bear. Moreover, because of the smaller number of participants in California's energy market there may be less competition and higher prices. By repealing PUHCA, Congress can lower prices and boost competition.

12. Do registered holding companies face unique problems if some states they serve adopt retail competition and some do not?

Registered holding companies serving several states will face unique problems if some of those states adopt wholesale competition and some do not or each state adopts a different date for implementing a competitive wholesale bulk power market. If this were to happen, holding companies would be in the untenable position of having some of its generation deregulated in states where wholesale competition is adopted and some of its generation still regulated in states that have not adopted wholesale competition. However, if the entire region where the holding company is located implements a wholesale bulk power at the same time, it does not matter whether one state served by the holding company adopts customer choice and another state does not. As referenced above, customer choice is, in essence, a paper settlement process that occurs after the real-time bidding and dispatch of the market generating resources.

13. How do the various retail competition proposals presently pending before the Congress affect decisions regarding stranded costs for registered holding companies? Do you support any of the formulations in these bills? Do you have alternate recommendations on this or other issues unique to registered holding companies if Congress enacts retail competition legislation?

The legitimate proposals pending before the Congress suffer from the same infirmities that afflict similar proposals offered at the state level, namely they are long on generalities to the effect that the problem of stranded cost should be addressed but short on the specifics as to how stranded cost will be quantified and recovered. This underscores the difficulty of comprehensive federal restructuring legislation because the parameters of the stranded cost issues are so diverse that the problem should be addressed on a utility-by-utility basis at the state level. However, if states refuse to do so, then Congress will have to fill the void. Another proposal before the Congress solves the stranded cost problem by making it disappear at the expense of utility investors. Congress could take the same approach to the problem of the federal deficit by simply defaulting on all federal debt.